Arunachalam & Ors v Kwality Textiles (Malaysia) Sdn Bhd

HIGH COURT (KUALA LUMPUR) — ORIGINATING SUMMONS NO D2-31-115-88
VC GEORGE J
4 JANUARY 1990

Companies and Corporations — Articles of association — Transfer of shares — Directors refusing to register transfer of shares — Registration of transfer would result in company breaching condition of its only business of manufacturing — Whether articles of association give directors discretion to refuse to register transfer of shares

Companies and Corporations — Shares — Transfer of — Directors refusing to register transfer — Whether directors have discretion to refuse to register transfer of shares

The plaintiffs were existing members of the defendant company. They applied by way of originating summons for the rectification of the register of members of the defendant company to have their names registered as owners of certain shares that had been transferred to them. The directors of the defendant company had refused to register the transfers in favour of the plaintiffs in purported exercise of their powers under art 44(1) of the articles of association of the company. Article 43 of the articles of association of the company allowed a proposed transferor of shares to transfer or sell his shares to any person at any price if the company cannot within a stipulated period find any member willing to purchase the shares of the proposed transferor.

The directors stated that although they were not obliged to assign any reason for the refusal to register the transfer, the reason was that the transferee was a non-Malaysian and the transfer, if registered, would result in less than 51% of the issued shares of the company being held by Malaysians. This would in turn run foul of one of the terms of the manufacturing licence which the manufacturing company held in respect of its only business.

Held, allowing the plaintiffs' application:

(1) The directors had no discretion to refuse to effect a transfer of shares from one member to another. If the transfer of shares is from a member to someone outside the ring of members, the directors' discretion to decide whether the proposed transfer is to be registered is limited by the art 43 procedures. Once the directors had failed to find a willing purchaser as provided by art 43, the directors may not rely on art 44(1) and refuse to register a transfer in favour of any other transferee. To otherwise hold would mean there would be a contradiction in terms of art 44(1) and art 43.

(2) The fact that the transfer would result in the company losing its licence would not per se allow the company to go against its articles of association. The company has to make adjustments and perhaps seek to have their licence amended or move to other fields of business where the equity structure was acceptable to the authorities.

[*Editorial Note*: The defendant has appealed to the Supreme Court vide Civil Appeal No 02-50-90.]

Cases referred to

1 *Greenhalgh* v *Mallard* [1943] 2 All ER 234 (folld)
2 *Re Copal Varnish Co Ltd* [1917] 2 Ch 349 (folld)
3 *Re Tahansan Sdn Bhd* [1984] 1 MLJ 204 (folld)

Porres Royan for the plaintiffs/applicants.
N Chandran for the defendant/respondent.

Cur Adv Vult

VC George J: By this originating summons, the plaintiffs applied for the rectification of the register of members of the defendant company by having their names registered as owners of certain shares that had been transferred to them. Prior to and at the time of the transfers and of the submission of the memoranda of transfer to the board for registration, the plaintiffs and each of them owned other shares in the defendant company and as such were already members thereof.

The directors of the company had, however, refused to register the transfers even though the transfers were in favour of persons who were at all relevant times members of the company. The directors say that art 44(1) of the articles of association of the company allows them, in their absolute discretion without assigning any reason, to refuse to register any transfer to a person they do not approve and that it was in the exercise of that discretion that they had refused to register the transfers. They say that although they are not required to assign any reason for the refusal, the reason for the refusal was that the transferees being non-Malaysian, the said transfers, if registered, would result in less than 51% of the issued shares of the company being held by Malaysians which would run foul of one of the terms and conditions of the manufacturing license that the defendants hold in respect of its only business, the manufacture of cotton yarn, synthetic yarn and bleached yarn, the said term and condition being that Malaysians should hold not less than 51% of the shares of the company.

The relevant articles of association of the defendant company are the following:

> 40 A share may be transferred by a member or other person entitled to transfer (hereinafter called 'the transferor') to any member selected by the transferor; but no share shall be transferred to a person who is not a member so long as any member (or any person selected by the directors as one whom it is desirable in the interests of the company to admit to membership) is willing to purchase the same at the fair value.
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> 41 Except where the transfer is made pursuant to arts 39, 42 and 54 hereof, a person proposing to transfer any share (hereinafter called 'the proposing transferor') shall give notice in writing (hereinafter called the 'transfer notice') to the company that he desires to transfer the same. Such notice shall specify the sum he fixes as the fair value, and shall constitute the company his agent for the sale of the share to any member of the company at the price so fixed or at the option of the purchaser, at the fair value to be fixed by the auditors of the company. The transfer notice shall not be revocable except with the sanction of the directors.
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> (I pause to note that an examination of arts 39, 42 and 54 shows that the reference to them here is meaningless and is an obvious error. The draftsman must have had other articles in

mind for the exception to art 41 and not arts 39, 42 and 54. Nothing, however, in the context of the issues here, turns on that.)

42 If the company shall within the space of 28 days after being served with such notice find a member (hereinafter called 'the purchasing member') willing to purchase the share and shall give notice to the proposing transferor, he shall be bound, upon payment of fair value, to transfer to the purchasing member.

43 If the company shall not within the space of 28 days aforesaid find a member willing to purchase the share and give notice in the manner aforesaid, the proposing transferor shall at any time within six months afterwards be at liberty to sell and transfer the share to any person at any price.

44 (1) The directors may in their absolute discretion without assigning any reason refuse to register any transfer of shares to a person of whom they shall not approve and they may also refuse to register any transfer of shares on which the company has a lien.

In *Greenhalgh* v *Mallard*,[1] Lord Greene MR, in construing similar provisions in the articles of association of a company, said at p 237B:

> Questions of construction of this kind are always difficult, but in the case of the restriction of transfer of shares I think it is right for the court to remember that a share, being personal property, is prima facie transferable, although the conditions of the transfer are to be found in the terms laid down in the articles. If the right of transfer, which is inherent in property of this kind, is to be taken away or cut down, it seems to me that it should be done by language of sufficient clarity to make it apparent that that was the intention.

In that case, the validity of certain transfer of shares by a company was in issue. The relevant article (art 10) was analysed by Lord Greene at p 236B which analysis is well worth looking at in extenso:

> That article is divided into five lettered paragraphs, (a), (b), (c), (d) and (e). It starts in para (a) with an express and clear prohibition against transfers to persons who are not members of the company, save in the circumstances specified. It says:
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> 'No shares in the company shall be transferred to a person not a member of the company so long as any member of the company may be willing to purchase such shares at a fair value to be ascertained in accordance with sub-cl (b) hereof.'
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> Pausing there, it cannot be suggested that sub-cl (a) contains any prohibition express or implied against transfers to persons who are members of the company. The object of it is quite clear: it is to put a clog upon the power to transfer outside the ring of members of the company, and nothing else. It tells us that in para (b) it is going to give directions for ascertaining the fair value which is referred to in para (a) and in para (b) such directions are to be found in the usual machinery of transfer notices, and so on. Paragraph (b) begins with language which, when read literally and apart from any context, is, I think, quite rightly described as unqualified and general in its application. Its words are as follows:
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> 'If any member desires to sell or transfer his shares or any of them, he shall notify his desire to the directors by sending them a notice in writing (hereinafter called 'a transfer notice') to the effect that he desires to sell or transfer such shares.'
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> It then goes on to lay down directions as to the form of the transfer notice and for ascertaining the fair value of the shares.
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> In the present case the transfers that are attacked were in favour of members of the company, and accordingly, if this article on its true construction allows unrestricted sales amongst members of the company, those transfers were properly passed. On the other hand, if para (b) is to be read as of general application to all sales, whether to members or non-members, then it is a condition of the validity of any transfer, whether to a member or a non-member, that the shares shall in the first instance have been offered to the members as a whole in the manner specified in the paragraph. Nobody can suggest that these articles are artistically drawn; indeed, the draftsman appears to have endeavoured to improve upon certain well-known forms, and his efforts at improvement are not particularly happy. Article 10 (d) provides for what is to happen if the directors are unable to find a purchaser among the members of the company. In that event:
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> '... the selling member may sell such shares as remain unsold to any person, though not a member of the company, and at any price...'
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> subject to an overriding right in the directors to refuse registration in the cases there mentioned.
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> It is perfectly just to observe that the opening words of para (b), if read out of their context, are of general application, and the phrase:
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> 'If any member desires to sell or transfer his shares or any of them...'
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> would appear to apply to any sale or transfer, whether to a member or not. Counsel for the appellant wishes us to read the paragraph in that sense. It is to be observed that, if the paragraph be read in that sense, the effect is to remove all content and meaning from the phrase 'to a person not a member of the company' in para (a). The reason why I say that is that the argument of counsel for the appellant involves finding in para (b) a prohibition against transfer which applies both to transfers to members and transfers to non-members, and, if that prohibition is to be found in para (b) it has the effect of making unnecessary — and, indeed, meaningless — the words 'to a person not a member of the company' in para (a). By so construing para (b), the article will read as containing a prohibition that no shares in the company shall be transferred to any person, whether a member of not, so long as any member may be willing to purchase such shares. That result is one which certainly points strongly in the direction of the correctness of the opinion formed by Uthwatt J, which was that para (b) does not apply to cases where the proposed sale is a sale to a member.

That approach to construction used by Lord Greene can and should be applied to the construction of arts 40 to 44 in the instant case. Article 40 does not contain any prohibition express or implied against transfer to members of the company. The position here is as was found by Lord Greene in *Greenhalgh*[1] with reference to art 10(a) in that case: the object of art 10(a) there and of art 40 here is quite clear — it is to put a clog upon the power to transfer

outside the ring of members of the company and nothing else.

And just as art 10(b) there was not to be read in isolation but in the context of the various parts of art 10, art 44(1) here should be read in the context of all the articles that come under the heading 'Restrictions of Transfer' and in particular arts 40 to 44. And it is by reading the articles in that manner that the question that arises which is 'does art 44(1) have a general application or is the application limited?' be considered and answered.

Now, art 43 provides a test that helps to arrive at the answer to the said question. If art 44(1) has a general application, then it would apply to a transfer pursuant to art 43 — which provides for the 'liberty to sell and transfer the share to any person at any price'. As can be seen from the terms of art 43, this liberty to sell and transfer to any person is given after the directors have failed to find a willing purchaser from among the members of the company. And the directors having failed to find a willing purchaser and art 43 expressly giving the proposed transferor the said liberty, would the directors thereafter be entitled to invoke art 44(1) and refuse to register a transfer duly submitted in favour of the transferor's choice of a transferee?

In my judgment, such a situation involving arts 43 and 44(1) provide a contradiction in terms. Having in mind what is settled law, that a shareholder has a free right to transfer his shares to whom he will — *Re Copal Varnish Co Ltd*[2] — it is clear that art 44(1) is not meant to and should not apply to art 43 transactions. Once the directors have failed to find a willing purchaser from among the members, a transfer to a purchaser of the transferor's choice, whether he is a member or not, if submitted within the six months prescribed by art 43, cannot be vetoed by the directors.

It follows and I hold that art 44(1) has no general application. And having arrived at that conclusion, it is not difficult to hold, as I do, that on a true construction, in as much that art 44(1) has no application to an art 43 transaction, it has no application to transfers from member to member. The directors have no discretion to refuse to effect a transfer of shares from one member to another. It is only where a member proposes to transfer his shares to someone outside the ring of members that the directors have a right to decide whether the proposed transferee is acceptable to them. Even that right is watered down by the art 43 procedures.

As has been seen, prima facie, a share in a company is transferable and if that right of transfer is to be taken away or cut down, it has to be done with language of sufficient clarity. In my judgment, if it was the intention of the draftsman of the memorandum of articles of the defendant company to cut down on the right to transfer from member to member, the language he has used is not sufficiently clear for effect to be given to such intention and as such and in any event applying the contra preferentum rule, the articles have to be construed as not cutting down on the right of transfer from member to member. The directors had no discretion to refuse to accept the transfers that had been made in favour of the plaintiffs.

As to the effect of the possibility that the transfers if allowed could result in the company losing its licence to manufacture, that in my view per se does not allow the company to go against its articles of association which are the terms and conditions of the contract between the company and its members. I would with respect follow NH Chan J in *Re Tahansan Sdn Bhd*[3] where he held that the court will not countenance the going back on an agreement binding on a company even if thereby there is a real danger of the company losing its manufacturing licence. The company has to make adjustments and perhaps should seek to have the terms of their licence amended or move into other fields of business where the equity structure they have is acceptable to the authorities.

The plaintiffs were granted the orders sought even though the consequential transfers could result in the company being in breach of the terms and conditions of its manufacturing licence.

Application allowed.

Solicitors : *Shook Lin & Bok; Adnan Sundra & Low.*

Reported by *Teoh Ai Lin*